

COMMONWEALTH OF MASSACHUSETTS

APPELLATE TAX BOARD

LEO LAKE, III

v. COMMISSIONER OF REVENUE

Docket Nos.: C319269, C321930
C322253, C328855

Promulgated:
June 21, 2017

These are appeals filed under the formal procedure pursuant to G.L. c. 58A, § 7 and G.L. c. 62C, § 39 from the refusal of the appellee, the Commissioner of Revenue ("Commissioner"), to abate income taxes assessed against the appellant, Leo Lake, III, and his spouse for the tax years 2007 through 2013 ("tax years at issue").

Commissioner Good heard these appeals. Chairman Hammond and Commissioners Scharaffa, Rose, and Chmielinski joined her in the decisions for the appellee.

These findings of fact and report are made pursuant to the appellant's requests under G.L. c. 58A, § 13 and 831 CMR 1.32.

Leo Lake, III, pro se, for the appellant.

Kevin M. Daly, Esq. and Roger H. Randall, Esq. for the appellee.

FINDINGS OF FACT AND REPORT

On the basis of the testimony and exhibits offered into evidence at the hearings of these appeals, the Appellate Tax Board ("Board") made the following findings of fact.

The appellant and his spouse, Stacy Lake (together, the "Lakes") timely filed a joint Massachusetts Resident Income Tax Return, Form 1, for each of the tax years at issue ("Returns"). The Returns reflected substantial unreimbursed employee business expenses claimed on Schedule Y, business expenses claimed on Schedule C, and medical/dental expenses. Based on a review of the Returns, the Commissioner initiated and conducted audits, ultimately issuing assessments to the Lakes for the tax years at issue. The following table illustrates income reported by the Lakes for the tax years at issue and the expense deductions that were disallowed by the Commissioner.

Tax Year	Wages	Employee Expenses	Schedule C Income	Schedule C Expenses	Med./Dent. Expenses
2007	\$83,307	\$26,899	-0-	-0-	\$14,278
2008	\$117,364	\$41,266	\$2,054	\$2,054	\$15,261
2009	\$64,876	\$58,965	\$15,475	\$3,056	\$24,853
2010	\$185,712	\$43,785	\$16,856	\$75,212	\$71,965
2011	\$102,422	\$38,768	\$24,948	\$71,458	\$27,041
2012	\$213,311	\$35,808	\$27,296	\$170,709	\$22,428
2013	\$134,959	\$24,648	\$32,543	\$116,488	\$16,042

All relevant jurisdictional documents, including Notices of Intent to Assess, Notices of Assessment and Notices of Abatement Determination, as well as Applications for Abatement, Forms CA-6, and Petitions before the Board, were issued or filed timely. Based on the foregoing, the Board found and ruled that it had jurisdiction to hear and decide these appeals.

The appeals were heard during two hearings; the first was held on February 2, 2016 and addressed tax years 2007 through 2011, while the second addressed tax years 2012 and 2013 and was held on April 11, 2016.

The issue presented in these appeals was whether the Lakes were entitled to disallowed expense deductions. The appellant's arguments relating to tax years 2012 and 2013 were, however, distinct from those for the prior years at issue. Thus, they are addressed separately in these findings of fact and report.

Background

During the tax years at issue, the appellant was employed in a number of sales-related positions, each of which, according to his testimony, necessitated use of his car and required him to incur various expenses in

connection with his job duties.¹ The appellant acknowledged that throughout the tax years at issue, his employers each had policies that provided for reimbursement of employee expenses, but asserted that his employers' reimbursements were not nearly equal to the expenses he had incurred.

The appellant testified that the Schedule C income and expenses at issue were all related to a small business operated by Mrs. Lake out of the basement of their home. The business, which was operated as a sole proprietorship and had no additional employees, was called "Small Singers and Shakers" and offered music lessons to children.

Finally, the appellant testified that his family had incurred substantial medical expenses during the tax years at issue, in large measure because his young child had ongoing serious medical issues.

Tax Years 2007 through 2011

As previously noted, the hearing conducted on February 2, 2016, addressed tax years 2007 through 2011.² During the hearing, the appellant stated that he did not possess, nor

¹ The Commissioner did not contest the appellant's status as an "outside salesperson," a category of taxpayer entitled to deduct certain unreimbursed employee business expenses under G.L. c. 62, § 2(d). Consequently, that status is not addressed in these findings of fact and report.

² At the outset of the hearing, the appellant stated that he had brought documentation to substantiate most of the expenses at issue for tax years 2012 and 2013, but was not fully prepared to proceed for those years. The presiding Commissioner determined that the latter years should be addressed in a separate hearing.

did he intend to produce documentation to substantiate any of the disallowed expenses. He stated that relevant documentation had been destroyed in a basement flood in his home during the spring of 2010.³ Further, he asserted that the Department of Revenue ("DOR") had either lost or ignored documentation that he had already provided to the DOR through his then accountant.

For several reasons, the Board found that the appellant's arguments were simply not credible. To begin, the appellant's claim that documents had been provided to the DOR was unsubstantiated. The appellant testified that his accountant "who worked on a previous issue with the Department of Revenue sent those documents [relating to 2007 through 2010] in multiple times." This claim was not corroborated by the accountant or by any documentation relating to the tax years at issue. Moreover, the Commissioner presented extensive credible testimony about procedures applicable to the intake of materials submitted by taxpayers and how those procedures were applied to the audits involved in these appeals. In particular, documents received by the DOR's Audit Division are date stamped and

³ Curiously, a document submitted into evidence by the appellant contained a description of his prior claim that documents relating to an Internal Revenue Service audit of the Lakes for tax years 2005 and 2006 had been destroyed in a flood that preceded the flood in the spring of 2010.

an explanatory entry is made in an "audit log," a description of virtually every event relating to a given audit. The detailed audit logs relating to these appeals described requests for documentation issued by the DOR as well as a phone conversation between an auditor and the appellant during February of 2013 in which the appellant stated his intent to submit documentation for tax years 2010 and 2011. The DOR's records, however, do not reflect receipt of any documentation relating to tax years 2007 through 2011.

The Board found the appellant's claims regarding the effects of a flood in his basement equally unpersuasive. While a flood may have damaged the Lakes' basement, its timing in the spring of 2010 would have had no effect on the appellant's ability to retain and provide contemporaneous documentation of expenses for the balance of tax year 2010 as well as tax year 2011 for which the appellant provided no documentation to either the DOR or the Board. The appellant made no attempt to address this fact. Moreover, the audit relating to tax years 2007 and 2008 commenced before the spring of 2010, at which time the DOR requested documentation of the contested expenses. Yet there is no credible evidence that the appellant submitted

a single document to the DOR prior to the spring of 2010.

Finally, the Board found it noteworthy that in the several years between the spring of 2010 and the hearing before the Board in February of 2016, the appellant did not attempt to obtain any records from third parties - such as banks, insurance companies or credit card companies - to substantiate at least a portion of the contested expenses. When asked directly by the presiding Commissioner why this was so, the appellant proffered a variety of excuses ranging from no longer having certain credit cards to past employers having gone out of business.

The disallowed expenses claimed by the Lakes appeared excessive on their face. For the tax years 2007 through 2011, the appellant, who was entitled to reimbursement for expenses from each of his employers, claimed unreimbursed employee expenses amounting to almost forty percent of his reported wages. Not only did he fail to document a single dollar of the contested employee expenses, but he did not offer a coherent explanation of their substance or how and when they had been incurred. The disallowed Schedule C expenses, which were similarly undocumented or explained, amounted to more than 2.5 times the income associated with

Mrs. Lake's small business.⁴ Finally, although the record indicated that the Lakes' child had ongoing medical issues, no information or documentation relating to the contested medical expenses, which exceeded \$150,000, was offered by the appellant.

In sum, the Board found and ruled that the appellant failed to substantiate any of the contested deductions and that their disallowance by the Commissioner was proper. Moreover, taking all of the available evidence into consideration, the Board found that the appellant's various explanations for his failure to provide documentation to substantiate deductions, as well as his assertion that documents had been submitted to the DOR, lacked credibility and should be afforded no weight.

Tax years 2012 and 2013

As with tax years 2007 through 2011, the issue for tax years 2012 and 2013 was whether the Lakes were entitled to unreimbursed employee business expenses, Schedule C business expenses, and medical/dental expenses that were disallowed by the Commissioner. Despite having explicitly stated, both in testimony and evidentiary documents, that

⁴ The appellant posited that a portion of the Schedule C expenses related to \$60,000 of damage that resulted from the 2010 flood. The monetary value of the damage, however, was not substantiated, nor were the reasons that a specified amount should be allowable against Mrs. Lake's Schedule C income.

he possessed and intended to submit documentation to both the DOR and the Board to substantiate disallowed expenses relating to tax years 2012 and 2013, the appellant ultimately provided none.⁵

As the April, 2016 hearing at the Board relating to these appeals commenced, the appellant stated that he did not intend to submit any documentation and that his "appeal [was] strictly on the audit process and how it was not followed by the Department of Revenue." In this regard, the appellant's arguments were twofold: he had not been afforded sufficient time to gather documentation; and in contravention of an informational document published by the DOR entitled "The Taxpayer Bill of Rights," there had been no handwritten signatures on certain correspondence that was sent to the Lakes by DOR. The Board found that these arguments lacked merit.

On February 27, 2015 and March 13, 2015,⁶ DOR's Audit Division issued written Notifications of Audit ("Notifications") to the Lakes informing them that their Returns for tax years 2012 and 2013 had been selected for

⁵ Shortly before the hearing, the appellant submitted two boxes of documents to the Commissioner. The documents were disorganized and did not appear to relate to specific claimed expenses. The appellant chose not to submit the documents into evidence.

⁶ The latter Notification differed substantively from the first in only one respect; it included a request for substantiation of a Septic System Credit claimed by the Lakes for tax year 2013.

audit. The Notifications contained explicit requests for documentation to substantiate the expenses at issue in this appeal and the second Notification informed the Lakes that failure to substantiate claimed deductions within thirty days would result in their disallowance. The appellant responded to the Notifications by letter in early April, requesting an extension of time to provide documentation to the DOR. The auditor granted an extension until May 4, 2015, but did not rule out further extensions. As of May 20th, the Lakes had provided no documentation to the Audit Division and had not requested a further extension of time to do so. The auditor then determined that a Notice of Intent to Assess ("NIA") should be issued to the Lakes, which in pertinent part would incorporate disallowance of the expense deductions at issue in this appeal. Consistent with this determination, the Commissioner issued an NIA dated May 25, 2016. By its terms, the Lakes had thirty days to respond to the NIA. No response was forthcoming and the Commissioner issued a Notice of Assessment on July 13, 2015. The Board found and ruled that this chronology was fundamentally sound and presented no procedural or other infirmity that might undermine the validity of the assessment.

The Board found and ruled that the appellant's argument regarding handwritten signatures was also without merit. Though the record in this appeal did not definitively establish whether the Notifications (on which the appellant placed emphasis) or other correspondence were, in fact, hand signed, the Board ruled that the absence of such a signature was not dispositive. The Notifications, which the Lakes received and responded to, identified the DOR employee responsible for the audit, from whom the appellant sought and received an extension of time to provide requested information. No evidence presented indicated that the appellant was or could have been prejudiced by the absence of a hand-written signature on the Notifications or any other correspondence and there is no statutory or regulatory requirement mandating a hand-written signature.

Having found the appellant's arguments unpersuasive, and lacking substantiation of any of the contested expense deductions for tax years 2012 and 2013, the Board found and ruled that the Commissioner properly disallowed the deductions.

Conclusion

Based on all of the evidence in these appeals, the Board found and ruled that the Lakes were not entitled to

the contested expense deductions for the tax years at issue. The Board's findings and rulings were premised primarily upon the appellant's failure to substantiate any of these expenses, which totaled more than \$900,000 over seven tax years and represented approximately ninety percent of the Lakes' reported wages and Schedule C income during this time. The weight of the evidence also led the Board to conclude that the appellant's various explanations for his failure to substantiate the expenses and his claim that documentation had been submitted to the DOR lacked credibility.

Based on the foregoing, the Board issued decisions for the appellee in these appeals.

OPINION

Massachusetts adjusted gross income includes some but not all of the deductions allowable under the Internal Revenue Code. G.L. c. 62, § 2(d). These "[d]eductions are to a large extent a matter of legislative grace." *Drapkin v. Commissioner of Revenue*, 420 Mass. 333, 343 (1995). It is also well-settled that a taxpayer bears the burden of demonstrating his or her entitlement to claim deductions against Massachusetts income. See *Horvitz v. Commissioner of Revenue*, 51 Mass. App. Ct. 386, 391-92 (2001); see also

Indopco, Inc. v. Commissioner, 503 U.S. 79, 84 (1992) (affirming that "the burden of clearly showing the right to the claimed deduction is on the taxpayer.") (additional citation omitted.)

To sustain this burden, the taxpayer must substantiate claimed deductions. In this regard, the Commissioner has promulgated regulations, pursuant to which individuals required to file a personal income tax return must retain such records as will enable the Commissioner to determine the amount of tax due. 830 C.M.R. 62C.25.1(9). To meet this obligation, the regulations require, generally, that taxpayers preserve and maintain "permanent books of accounts or records, sufficiently accurate and complete to establish the amount of gross income, deductions, credits or other matters." 830 C.M.R. 62C.25.1. Records required to be retained by individuals claiming business deductions on Schedule C "must be in sufficient detail and clarity to delineate and support each line item deducted on such Schedule C." 830 C.M.R. 62C.25.1(9).

Once an assessment has been issued, an appellant also bears the burden of proving his or her right, as a matter of law, to an abatement. See **M & T Charters, Inc. v. Commissioner of Revenue**, 404 Mass. 137, 140 (1989); **Stone v. State Tax Commission**, 363 Mass. 64, 65-66

(1973); see also *Staples v. Commissioner of Corps. and Taxation*, 305 Mass. 20, 26 (1940).

These appeals involve substantial unreimbursed employee business expenses, Schedule C business expenses and medical/dental expenses claimed by the Lakes on their Returns for the tax years at issue. From the time that the first audit relating to these periods commenced in 2009 through the hearings of the appeals by the Board in 2016, the appellant failed to provide documentation to substantiate any of the expenses at issue as required by applicable law. This failure stands in stark contrast to the appellant's written and oral statements that he possessed and intended to provide both the DOR and the Board with relevant documentation. Under these circumstances, the Board was compelled to find and rule that the appellant failed to sustain his burden of demonstrating his right to the claimed expense deductions and in turn, an abatement of tax.

The appellant never fully addressed his failure to substantiate the contested deductions. Instead, for tax years 2007 through 2011, he offered tenuous, incomplete and logically inadequate explanations, including a flood (one of two that occurred in relatively quick succession) that destroyed records and a bald assertion that documentation

for certain tax years had been submitted to the DOR on several occasions. The evidence, on balance, led the Board to find that the appellant's various assertions were not credible.

For two of the tax years at issue, 2012 and 2013, the appellant, having previously stated his intent to document the disputed expenses, abruptly changed course at the hearing before the Board, arguing that he was given insufficient time to provide documentation and did not receive hand-signed communications from the DOR. According to the appellant, either one of these deficiencies was sufficient to invalidate the assessment relating to tax years 2012 and 2013.

As discussed above, the audit was fundamentally sound and the Board could discern no infirmity that might undermine the validity of the assessment. The appellant's latter argument, in support of which he offered no legal precedent, was also unpersuasive. No evidence in the record indicated that the appellant was or could have been prejudiced by the absence of a hand-written signature on the Notifications or other correspondence with the DOR. Further, the Board is aware of no statutory or regulatory requirement mandating the signatures demanded by the

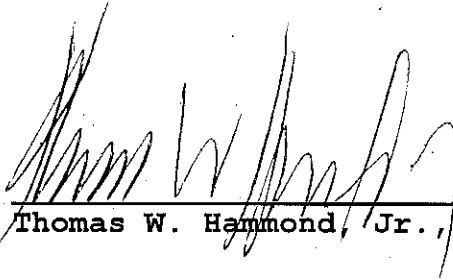
appellant. Indeed, applicable regulations undermine this assertion.

Pursuant to 830 C.M.R.62C.3.1, the Commissioner may publish certain "Public Written Statements" upon which taxpayers may rely for a variety of purposes. This same regulation describes specific "materials that are not Public Written Statements," which include "Other Written Materials." 830 C.M.R. 62C.25.1(10)(c). These materials, which include the Taxpayer's Bill of Rights cited by the appellant as mandating signed correspondence, "ordinarily . . . provide information" and "do not supersede, alter or otherwise affect provisions of the Massachusetts General Laws, Massachusetts regulations, Department Rulings or any other sources of the law." 830 C.M.R. 62C.25.1(10)(c)(2). Moreover, Other Written Materials "may not be relied upon, used or cited as precedent in the disposition of cases." *Id.* With this regulation in mind and absent precedent indicating a different result or prejudice to the appellant, the Board rejected the appellant's argument.

On the basis of its findings and rulings, the Board found and ruled that the Lakes were not entitled to the contested expense deductions for the tax years at issue and issued decisions in favor of the appellee.

APPELLATE TAX BOARD

By:



Thomas W. Hammond, Jr., Chairman

A true copy,

Attest:



Clerk of the Board

Asst.